# EXHIBIT B

# FINAL TRANSCRIPT

**Thomson StreetEvents℠**

## CNCT - Q4 2004 Connetics Earnings Conference Call

Event Date/Time: Jan. 25. 2005 / 4:30PM ET
Event Duration: 1 hr 5 min

### OVERVIEW

In 4Q04, EPS was $0.17. On a full-year basis, CNCT posted a profit of $0.52 per share. In 4Q04, the Co. signed two agreements with two of its larger wholesalers. CNCT finished 2004 with $76m in cash. CNCT is guiding total revenues of $190-200m in 2005. In 1Q05, the Co. forecast EPS on a diluted basis of $0.01-0.02. Q&A Focus: Soriatane, guidance, and Evoclin.

# FINAL TRANSCRIPT

CNCT - Q4 2004 Connetics Earnings Conference Call

## CORPORATE PARTICIPANTS

**Patrick O'Brien**
*Connetics - IR*

**Tom Wiggans**
*Connetics - President, CEO*

**John Higgins**
*Connetics - CFO, EVP*

**Greg Vontz**
*Connetics - COO, EVP*

## CONFERENCE CALL PARTICIPANTS

**Ken Trbovich**
*RBC Capital Markets - Analyst*

**Deb Nobleman**
*Piper Jaffrey - Analyst*

**Elliott Wilbur**
*CIBC World Markets - Analyst*

**Michael Tong**
*Wachovia Securities - Analyst*

**David Buck**
*Buckingham Research Group - Analyst*

**Dave Windley**
*Jefferies & Company - Analyst*

**Megan Murphy**
*Lazard Freres - Analyst*

**Mike Hearle**
*Leerink Swann - Analyst*

**Donald Ellis**
*Thomas Weisel Partners - Analyst*

## PRESENTATION

**Operator**

Good afternoon. My name is Aileen, and I will be your conference facilitator. At this time, I would like to welcome everyone to the fourth-quarter earnings call for Connetics Corporation. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer period. (OPERATOR INSTRUCTIONS)

Thank you. I would now like to introduce our moderator, Mr. Patrick O'Brien. Sir, you may begin.

---

**Patrick O'Brien** - *Connetics - IR*

Thank you, and good afternoon, everyone. With me for today's conference call is Tom Wiggans, President and Chief Executive Officer; Greg Vontz, Chief Operating Officer and Executive Vice President; and John Higgins, Chief Financial Officer and Executive Vice President.

I will begin the call by addressing our forward-looking statements. Following this, I will turn the call over to Tom Wiggans.

As a reminder, the statements made in this call represent our judgment as of January 25, 2005. Our remarks and responses to questions during this conference call may constitute forward-looking statements, including plans, expectations, and projections, all of which involve certain assumptions, risks, and uncertainties that are beyond our control and could cause our actual results to differ materially from these statements. Those risks and uncertainties include, among others, that the Company may not be able to sustain profitability, and that sales growth and future product revenues may be lower, or expenses may be higher, than our projections in any quarter. We encourage you to take the time to review our recent filings with the Securities and Exchange Commission in the fourth-quarter earnings release issued earlier today, which present these matters in more detail. Connetics does not undertake any obligation to update any forward-looking statements made during this call.

At this point, I would like to turn the call over to Tom Wiggans.

---

**Tom Wiggans** - *Connetics - President, CEO*

Pat, thank you, and thanks, everybody, for joining us today. 2004 was a substantial growth and expansion year for the Company. Not only did we post significant revenue growth and turn profitable, the expanded revenue, income, and cash flow, especially from Soriatane, allowed us to substantially expand our business and increase our commercial presence in the dermatology market.

If I could focus now on the fourth quarter, as we moved through the fourth quarter, I was very pleased with the momentum that we saw, particularly in 2 areas. First, our increases in our existing product prescriptions for Luxiq, OLUX, and Soriatane was very encouraging. Gregory is going to review these in more detail. But in December, we hit all-time highs for both Luxiq and OLUX on our 100-gram SKU, which is the largest selling SKU. And we had the best month

for Soriatane since we took over promoting the product in April. These trends are continuing as we move into the new year.

Additionally, our managed care efforts across the board, but particularly for Soriatane, we believe, are also beginning to make an impact.

Secondly, while it is obviously still early for Evoclin, the initial impact of our sales and marketing efforts are very encouraging, and in fact, exceeding our expectations, which we believe bodes well for our entry into the acne market. We recognize this market is very competitive. We know we need to devote considerable resources, as well as expertise and bring competitive products to this market. But as we prepare not only to expand the launch of Evoclin, but prepare for a Velac launch, our plan encases (ph) that there will be a competitive product for Velac. But we have excellent data on Velac. We have now an expanded and very talented sales force. And we are confident that we will be successful in this market with our acne franchise, and in particular, with Velac.

As we move into 2005, our sales, product development, and technology development aspects of our business have never been stronger. In the sales area, the trends, as I mentioned above, in all products are quite encouraging right now. And our expanded sales force appears to be making an impact already. I believe this speaks directly to the quality of the sales representatives we were able to hire, as well as the continued promotional responsiveness of our products.

In the product development area, our product pipeline is the strongest it has ever been. Our 4-2-1 product development model continues to gain efficiency. And this year, we will have 4 clinical programs, and project that we will file 2 NDAs.

Third, in the technology area, our technology platform continues to expand. For example, Connetics Australia and our Center for Skin Biology here in Palo Alto are making an increasingly significant impact on our ability to formulate and assess new products and delivery technologies. We believe that the commercial launch and royalties from the formulations of Lamisil and/or Rogaine that we've licensed to Novartis and Pfizer -- sales could begin this year. And certainly, if that occurs, although royalties will probably be modest this year, we would forecast substantial ramp-up in those royalties next year.

And thirdly, our new VersaFoam emollient foam platform is a very exciting and good example of where we think we can take the business. The VersaFoam-EF is the basis for most of the next generation of our new products. The intellectual property around this VersaFoam formulation -- the patents were allowed in '04, and present us with a very broad intellectual property position covering this delivery technology.

Even more exciting is the reaction of dermatologists and their patients that we have now taken these products into our Phase III clinical trials. At our investigator meetings and the early feedback from the clinical trials sites, this formulation is as exciting to the dermatologists and the patients as we thought it would be.

As John will talk to you about, our steroid franchise this year will approach that $100 million revenue goal that we set forth several years ago. We believe based upon the opportunity for the VersaFoam-EF, the new categories and the new markets that that can take us into -- just in our steroid franchise, this new emollient foam delivery technology has the potential to double our steroid franchise. So we're very excited about the technology platforms such as the VersaFoam-EF. And I have no doubt that Connetics Australia and our product development team are going to continue to come up with outstanding new technology platforms, as well as formulate a continuous stream of products into those delivery systems.

Let me conclude with an outlook as we begin 2005 and kind of look through 2005 and into 2006. In the first quarter, clearly, our expanded sales force -- the major initiatives that we have each year to kick off the year, and a full-blown Evoclin launch -- going to be a very busy quarter for us. However, as we have the past, we believe that this investment early in the year gets 2005 off to a great start and with considerable momentum.

Those of you who have followed the story of the company over the past several years I hope continue to appreciate the operational and financial leverage, and financial and operational potential of this business. We saw it in 2004 as we swung from a loss in 2003 to a considerable profit in 2004. I recall back as other companies kind of move towards profitability, there's always that profit watch -- are they going to be to 1 or 2 cents profitable? We swung from a loss in 2003 to a profit of 52 cents in 2004 -- so considerable leverage, and obviously, a dramatic improvement in cash flow.

We see it again in '05 as we forecast approximately a 35 percent increase in revenues and approximately a 70 percent

increase in earnings. And we expect this to continue, if not accelerate, as we go into 2006.

Our ability to deliver innovative product development and substantial sales growth through a relatively modestly expanding organization remains a key part of our business model. And we continue to deliver on this.

Our goal a couple of years ago was to have a sales per sales rep goal of $2 million -- $2 million per sales rep. And as we looked last year towards the end of 2004 prior to our expanded sales force, we were on track to exceed that goal. We now feel with our expanded sales force of 124 we can do 2.5 to 3 million per sales rep over the next couple of years.

In summary, we believe our business plan continues to be one of the most attractive in the specialty pharmaceuticals sector. Our expanded sales force and increasing commercial presence; our ongoing product development model, delivering innovative new products and innovative new technologies for dermatologists and their patients -- we believe will continue to generate substantial revenue, income, and value growth for our shareholders.

With that, I'll turn it over to John.

---

**John Higgins** - *Connetics - CFO, EVP*

Thanks, Tom. I'm going to give a review of the fourth-quarter and full-year financial highlights for 2004, and then walk through the guidance we've provided in a little more detail in our press release for 2005.

Fourth-quarter results -- we're very pleased with revenue mix. OLUX -- the product line came in at 16.3 million; Luxiq, 6.2 million. Soriatane contributed 17.8 million in the fourth quarter, and Evoclin, 2.9 million.

For the full-year, very pleased with, again, the contributions of all of our products. OLUX on a full-year basis, 61.9 million; Luxiq, 23.6 million. Soriatane rolled up at 53.3 million. And Evoclin -- again, we just launched in the last couple of weeks in December. We recorded 2.9 million, as I indicated.

Our gross margins -- we finished fourth quarter with a 90 percent mix on gross margins. In the fourth quarter, as we alluded to on our third-quarter conference call in October, we anticipated signing distribution service agreements. We did that. We signed 2 agreements with 2 of our larger wholesalers. The accounting for this -- the cost will hit our sales line. It will be booked as a discount to (technical difficulty) sales. The impact in the fourth quarter was very small.

Expenses -- as we look at the fourth-quarter expenses for SG&A, it came at 22.8 million. As we look at the quarter, it was a very important quarter. We pulled for the expansion of our sales force. We saw almost a full quarter of the sales force expansion costs. Of course, the Evoclin launch activities -- we did book promotion fees for UCB, our copromotion partner for our steroid products. In addition, we also recognized about a 600,000 write-off for Soriatane, which relates to Soriatane samples as well as marketing material that were for the samples, as well.

In the research and development area, we spent 5.7 million in the fourth quarter. This is a higher quarterly run rate than in earlier part of 2004. As we have discussed, the last several months, we have increasing clinical activities that we expect to continue into 2005. In addition in this line, we also had about a 500,000 write-off for Extina due to the non-approvable letter we received from the FDA for that product in November.

Tax for the quarter was 459,000 or 7 percent on a pretax basis -- of our pretax profits, that is. That 7 percent is the average for the full year.

We're pleased fourth quarter came in with earnings of 17 cents per share. And on a full-year basis, we have posted a profit of 52 cents per share.

We finished the year with $76 million in cash. This includes the cash payment for the Velac milestone. The cash actually was paid in the fourth quarter. In addition, it includes a couple of million dollars in buildout cost for a new facility, as well as receivables increasing with the launch of Evoclin.

Before I talk about '05 guidance, just a quick review. We're pleased with our financial performance throughout the year. We started 2004 with revenue guidance, the midpoint of 92 million, and an earnings expectation of 23 cents.

We acquired Soriatane early in the year, and had raised revenues and earnings -- our expectations at the time early this year was 120 million in revenues and 34 cents in earnings. And obviously now, we're pleased to report total roll-up of revenues of just over 144 million and 52 cents in earnings per share.

Now I'm going to move to guidance. I want to talk first about the full year for 2005. We're guiding total revenues of 190 to $200 million. There are (ph) steroid lines -- Luxiq and OLUX -- we see that franchise growing at close to 10 percent, making up nearly 50 percent of our revenue base.

Soriatane, we're forecasting approximately 20 percent year-over-year growth, making up approximately one-third of our revenue. And our acne products -- Evoclin, which we just launched, and Velac, we expect to be launched midyear, making up the balance or roughly 20 percent of our sales. That amount for our acne franchise in 2005 we expect to be split roughly 50-50 between both Evoclin and Velac.

Royalty and contract revenue we forecast to be flat 2005 over 2004. We expect the royalty line to pick up in 2006 with the increase in royalties from both Novartis and Pfizer anticipated at that time.

Margins for the full year we're forecasting at 90 percent. And when we break down expenses, total operating expenses, including both SG&A and R&D, we expected to come in in the range of 116 to 123 million.

SG&A -- as we look specifically at that area, we're looking at 88 to 93 million in SG&A. Specifically, we're capturing a full year of the expanded sales force; two product launches -- although we launched officially Evoclin in December, we're still investing significantly in the launch of that brand, plus we'll have the launch of Velac.

For the full year -- 5 (ph) marketed brands with all the incumbent promotion, materials, and sampling, we have increased visibility in the dermatology community, and higher expenses associated with our new facility.

In research and development, we'll see growth year over year. Expenses are projected to be 28 to 30 million, due principally to 3 Phase III programs that will be ongoing throughout the year. We anticipate filing to NDAs this year. And also, we have expanded formulation work ongoing with our pipeline.

With the expected approval of Velac in the middle of this year, we will pay Yamanouchi a final milestone payment of $5 million. We forecast this will be a third-quarter payment. We have looked at the accounting. We expect to capitalize this payment and amortize it over the life of the patent, which is approximately 10 years.

Total depreciation and amortization -- the noncash charge of the business we expect to be 16 to $16.5 million on a full-year basis. We're forecasting a tax rate of 10 percent, generating earnings per share of 88 to 92 cents on an if-converted basis. We have an outstanding convertible note. We're anticipating if that level of profitability will (ph) present on an if-converted basis, we're assuming 42.3 million shares. And you would add back interest and loan cost of $2.3 million.

Now just to comment specifically to the first quarter here -- we're looking at revenue of 42 to $44 million. This is for the existing 4 products we're marketing right now -- again, with gross margin averaging out at 90 percent.

Expenses -- we're looking at total operating expense of 33.5 to $35.5 million. This is an increase over our fourth-quarter expenses. And this is consistent with the past 3 years. We have seen -- the first quarter has generated significant investment in the commercial side of our business in the last several years. This year is no exception -- notably now, since we're launching Evoclin.

SG&A -- we're looking at 27 to $28 million in expenses. Again, this captures a full quarter of the expanded sales force, a significant investment in the Evoclin product launch, 4 marketed brands, visibility at several major medical conferences, prelaunch activities for Velac, and again, higher expenses associated with the move to our new facility.

In the R&D area, again, as we invest in our trial activities, we're seeing increased cost there, as well -- forecasting roughly 6.5 to $7.5 million in expenses for research and development. We're looking at 2 Phase III programs ongoing throughout the quarter, notably with the initiation of the OLUX-EF trial in the next several weeks. In addition, we'll have expanded formulation work.

With the tax rate we're targeting of 10 percent, we forecast earnings per share on a diluted basis of 1 to 2 cents for the first quarter.

Just my final comment -- I want to put some perspective on the growth and progress we've made here in '04 as it relates to now our guidance in '05 and how that sets us up for 2006. As Tom alluded to, we're beginning to really enjoy leverage on our financial model. 2005 -- we're very excited about it. It is another year of exciting growth for us.

In 2006, we see revenue driven by continued growth of Evoclin. We forecast enjoying a full year of Velac sales -- in

addition, potential new product launches at the end of 2006. And this is matched with expenses that we believe will begin -- the increases to flatten year over year. The last couple of years, we've seen tremendous investment in our commercial organization. We believe we're getting leverage off that.

As we look in '05 over '04, revenues grew in the mid-30 percent range. We forecast revenue growth '06 over '05 to be consistent with that growth range on the topline.

Expenses coming down -- the last couple of years, we've seen expense growth in the high 20 to 30 percent range year over year. '06 over '05, we expect expense growth to be in the 15 to 20 percent range.

The tax rate will go up. As we move through our net operating losses, we're forecasting tax in 2006 of a 20 to 25 percent range. And we forecast that earnings growth in '06 over '05 will be equal or greater to the earnings growth we're guiding to '05 over '04.

With that, I'll turn it over to Greg.

---

**Greg Vontz** - *Connetics - COO, EVP*

John, thanks. I'll kick off my comments first talking about our performance with our products in '04, and then I'll give a view ahead to '05, both on the commercial and product development sides of the business.

In 2004, we had a strong year for our steroid franchise, as was previously mentioned. With OLUX, we enjoyed a 30 percent increase in revenues in '04 over '03 that was fueled by a 14 percent increase in Rx growth year over year. As the product reached its fourth year, we hit our all-time high for prescriptions in '04, generating 324,000 prescriptions in 2004. And OLUX finished the year as the number-1 most frequently prescribed and highest-retail-dollar-generating super-high-potency topical steroid. So OLUX continues to be a strong product for us and, as it moves into its fifth year, looks to have continued growth and momentum.

With OLUX, we also enjoyed robust growth, despite the fact this product is in its fifth year. Total revenues year-over-year increased by 21 percent supported by an 8 percent growth in Rx's.

In terms of the mid-potency category, Luxiq finished up in the dermatology segment as the number 3 most frequently prescribed mid-potency topical steroid and number 1 in retail sales.

Now moving on to Soriatane, we enjoyed a 9 percent increase in retail sales over Roche's ownership of the product in 2003. On an Rx basis, we were slightly down. But importantly, I think we generated a lot of momentum going into the fourth quarter. And as we have started into the new year, as we look at our weekly data, we're now heading all-time highs for the products. So we're encouraged that we have generated some momentum.

And we wrapped up our 2004 with the very excited launch of Evoclin. Certainly, our marketing and sales teams did a super job with this introduction. In the first 2 weeks of December, including the holidays, we were pleased to have generated 2,000 prescriptions. That was generated by 650 writers -- so a very rapid adoption given the holiday timeframe.

And as we're seeing the weekly prescription data coming in, in January, we're seeing very, very strong growth trends for Evoclin. To put that in perspective, it appears right now that we are on pace with Evoclin to exceed the prescription adoption rate for OLUX. And OLUX was roughly twice as fast as Luxiq. So we're certainly very encouraged by these trends.

With that, let me turn my comments now towards the year ahead in 2005 and how we see the commercial business unfold and what our views are on the products. And then I'll conclude talking about our product development activities.

We really came off a lot of momentum in the fourth quarter with the expansion of our sales force. We've really seen an uplift in our prescription trends, and are very excited about the momentum we bring into the first quarter.

As John also mentioned, the first quarter is very, very busy for us. It's a time of a lot of conferences. It's our national sales meeting. We're come up to the AAD in a few short weeks here in February, as well as really focusing on the launch of Evoclin -- so a very, very busy time for us.

But as we look ahead to the business, we continue to see solid growth for our steroids. John had mentioned previously that we are looking for growth in the 10 percent range. And as Tom had previously mentioned at the J.P. Morgan conference, one of our corporate goals is to replace UCB going forward. So we continue to be encouraged by the potential for our steroids.

In specific, as we look to the future, Luxiq is now a maturing brand. And with the introduction of Velac in the second half of the year, we will no longer be actively promoting Luxiq. But it will be promoted in the PCP space, as we see there is continued growth potential for the product there.

OLUX has continued growth potential, robust growth potential, we believe, in '05. We have some pretty exciting new data that will be coming out on the product with regards to use concomitantly with Dovonex. We think that will continue to fuel growth, as well as our expanded sales organization. And so with the whole sales organization supporting OLUX in 2005, we look for robust growth for the product.

In terms of Soriatane for '05, we continue to believe that a generic competitor is unlikely to appear in '05. That is our planning strategy in case at this point. And we look to fuel growth of the product in '05 really based on 2 fronts. We've made a lot of progress first and foremost on the managed care side of the business. Our managed care group has been very active and very quickly has taken us from a previous level of no contracts with Roche to a point where we now have more than 100 million lives under contract. And we expect that number to exceed 200 million by the end of the first quarter.

Importantly, two-thirds of these lives are on second-tier. And probably most significant is we're projecting now by end of the first quarter that we'll have between 60 and 65 million lives under step care therapy requiring patients first to undergo 3 months of treatment with Soriatane before they would be eligible for a biologic. So on the basis of those 2 elements and the expanded sales force support of Soriatane, we're optimistic for a strong year in '05 with Soriatane.

As we also kicked off the early part of this year with a lot of focus on Evoclin, it will continue to be number one in terms of the promotional provision for our sales organization. Evoclin is an exciting brand. We have some very interesting new data that's going to come out at the February AAD.

One of the pieces of data that's already getting some traction with Evoclin is the now proven ability of the product to be compatible with benzoyl peroxide. We're hearing a lot of good feedback from physicians about how patients are adopting the vehicle, how it's working for them, and how they're applying it concomitantly with BPO.

So stay tuned on Evoclin. We look for more good things to come, and I know our sales force is going to do a super job there.

On the Velac front, as Tom mentioned, preparations are completely underway for getting ready to launch this product. And as part of our launch strategy, we have worked out kind of a pulsed release of clinical data. We're very excited at the upcoming AAD meeting in New Orleans that of the 11 abstracts that we have submitted and have been accepted, 5 of those are unique to Velac. And those abstracts highlight some brand new data that will play a critical role in supporting the label for this product. So stay tuned when that data comes out -- very, very exciting news for this product.

We additional have another tranche of data for Velac scheduled to be out at the summer AAD time to coincide with the launch of the product. So a lot of attention and energies by our marketing team and sales operations group being focused on preparations for Velac.

Just to conclude our forward-looking thoughts in '05 on the product mix. We previously had talked a little bit about where we are with Extina. We're going to be meeting with the FDA in the very near future to discuss requirements and what the process might look like for product approval. Once we have more clarity on the requirements in our decision, we'll update you on our plans for Extina.

Let me just conclude my remarks before I turn it back over to Tom with a quick discussion of what 2005 looks like for us on the product development front. It will be our busiest year in the history of the Company in terms of product development.

We're going to be developing 3 products specifically in '05 -- that is OLUX, Desilux, and calcipotriene. All of those will be our VersaFoam-EF emollient vehicle. To complete that development work, it's going to require us to conduct 4 Phase III clinical programs. In addition to that, we'll be completing a major Phase IV study for Soriatane. We'll be filing to NDAs, and anticipate the approval of Velac. So a very, very busy year for our development organization.

In specific, with regards to our Desilux program, our clinical operations group has done a superb job. We are more than halfway completed with our enrollment into the Phase III program. We would expect to file an NDA for this program before the end of the year, and will look for a second half of '06 approval of Desilux, which will be our first entry into the low potency topical steroid market.

Also, in regards to our OLUX program, we had a very positive meeting with the FDA late last year. We now have 2 Phase III programs ready to get underway imminently. Those are in both a topic dermatitis and psoriasis, which will bring us an even broader label. We intend then (ph) that with OLUX and our ethanolic (ph) foam. And so I think as we see the potential for these products, they truly are significantly larger than those with our hydroethanolic (ph) products today.

And then lastly, as we mentioned previously, we are on track to start our calcipotriene VersaFoam-EF program in the third quarter, and will give you more color on that as the year progresses.

Let me just conclude by talking about the state of play for our formulation candidates. As you know, last year late in the year we announced our clinical candidates. We'll plan to do that again this year. But for now, let me just say we have made some very, very exciting progress on some of the formulation candidates, specifically on the acne front. These are breakthroughs that previously weren't thought possible. So we're optimistic at this point we're going to have very unique products to put into the clinical development pipeline in '06.

So with that, let me now turn it over to Tom for concluding remarks.

---

**Tom Wiggans** - *Connetics - President, CEO*

Greg, John, thank you very much. Thank you all for your time on the phone and for your support of the Company. And for those employees that are no doubt on the call, thank you for your support. We've got a terrific employee base. And as Greg alluded to, our national sales meeting is imminently on the horizon, as is our annual kickoff meeting. It's an opportunity for us to get all employees together, focus them on the 2005 corporate goals, and keep the momentum and the excitement of the Company going.

As we alluded to -- or not so subtly alluded to, the financial and the sales momentum of the Company now we believe is considerable, as is the commitment and the passion and the excitement of our employees. So it is certainly our objective to keep that momentum going as we kick off 2005.

Just a couple of calendaring items for your attention -- our analyst day this year will be April 14. We'll be moving it up a little bit. Our analyst day will be April 14 in New York. It's scheduled for a 10:30 start at the Mandarin Hotel -- details to follow.

A couple of upcoming conferences -- John will be at the Piper conference this week in New York presenting on Thursday. Greg will be at the Merrill Lynch conference on February 8. And I will be at the Leerink conference in New York on March 1.

Again, thank you for your attention today. And with that, we'll open it up for questions.

---

## QUESTIONS AND ANSWERS

**Operator**

(OPERATOR INSTRUCTIONS). Ken Trbovich, RBC Capital Markets.

---

**Ken Trbovich** - *RBC Capital Markets - Analyst*

I was curious if you could help me out -- on the quarter, it seemed that Soriatane sales were a bit higher than we would've expected. Did you have international sales like you did during the earlier quarter of this year?

---

**Tom Wiggans** - *Connetics - President, CEO*

Yes, Ken, we did. And actually I want to just touch back on the numbers I cited. The Soriatane for the fourth quarter and full year are slightly larger than what I previously reported on the call. For the fourth quarter, they came in at 18 million as we indicated in the press release; the full year, 53.6 million.

The mix absolutely does include the sales to our international distributor. And our experience -- and obviously, we've looked at Roche's history -- is fairly consistent with their history -- the last several years. Obviously, we can't predict the timing entirely. But it does account for sales through that channel in the fourth quarter.

---

**Ken Trbovich** - *RBC Capital Markets - Analyst*

Okay. And I guess the reason I was sort of curious is it seemed like you had that sort of catch-up order in the second quarter, and this one -- I'm just not certain whether or not we've got a situation where we're not going to see another order for

several quarters, or do they have a pattern of ordering twice a year?

---

**Tom Wiggans** - *Connetics - President, CEO*

Right. Well, we've only had the product for less than a year. So it's hard for us to forecast exactly what to expect. Looking at the history with Roche, it seemed to be a very steady ordering pattern. On top of that, I'll add -- and we talked at some length around the second-quarter call -- there was about a good 6- to 8-week transitional period where orders were not processed to this channel as we were acquiring the asset. There was some question whether we would take over the relationship and whether we could meet their supply requirements. So that's why the second quarter was perhaps higher than expected.

As far as going forward, obviously, we're very pleased with the level of orders here in the fourth quarter. Our general guidance that we've given for '05 would reflect what we expect including that channel in '05.

---

**Ken Trbovich** - *RBC Capital Markets - Analyst*

Okay, and in terms of that 20 percent step-up, how much of a price increase does that include? So how much is volume versus price? And the reason I'm asking -- I'd like to go back to Greg and ask him to repeat something if I can after you answer that one.

---

**Greg Vontz** - *Connetics - COO, EVP*

Very briefly, Ken, I'll say -- although we've given some direction in terms of the '05 mix, we do not comment on the mix between price and volume. Clearly, we expect price all of these brands to grow on a volume base in 2005.

---

**Ken Trbovich** - *RBC Capital Markets - Analyst*

Okay. And if Greg could just step back to the comment about the step-care therapy. It went through rather quickly on the call, and I would appreciate it if you can go back and explain what proportion of the patients are actually under step-care therapy, and when the process began? I'm looking at the script data on a monthly basis. And December's numbers were actually down from the year prior. So I'm just trying to get a sense as to whether or not this actually a trend which has just begun, or one that started, perhaps, in the fourth quarter, and it's building now.

---

**Greg Vontz** - *Connetics - COO, EVP*

Ken, let me share with you a little more detail on this. Most of our contracting came into play late in the fourth quarter. As we wrapped up the year, we probably finished with a little over 30 million lives under step care. That momentum, though, with our contracting continues pretty briskly right now. And we would expect, as I said, to wrap up the first quarter somewhere in the neighborhood and 60 to 65 million lives. And that will probably be the peak under step-care therapy for us.

---

**Ken Trbovich** - *RBC Capital Markets - Analyst*

So it really is a building trend?

---

**Greg Vontz** - *Connetics - COO, EVP*

Yes; we certainly believe so.

---

**Operator**

Deb Nobleman, Piper Jaffrey.

---

**Deb Nobleman** - *Piper Jaffrey - Analyst*

2 questions. My first question is on your SG&A guidance for '05. You know, I noticed the guidance for the first quarter, which includes obviously mostly a product launch, etc., is pretty high. I'm just wondering if the Q3 numbers should also come up accordingly, because didn't you anticipate launching Velac at that time -- if it will sort of be lumpy, or if we're going to see a progression over the course of the year?

---

**Tom Wiggans** - *Connetics - President, CEO*

We aren't giving detailed quarterly guidance. I think generally, your analysis makes sense. Clearly, there's perhaps an increase in the period expense around the third quarter as we expect to launch that brand.

That is such a substantial product -- specifically, we are already incurring pre-launch expenses. That is hitting now. It'll hit in Q2. So it would smooth that out a bit.

Specific to the first-quarter expenses, they are large as it relates to prior years -- also, as I indicated, the growth over the last quarter -- but really speak to the fairly significant increase in our commercial operations as we move into 2005.

---

**Deb Nobleman** - *Piper Jaffrey - Analyst*

Okay, great. And then the second question -- I'm sure you get this question all the time. But just so we all hear -- what is your current understanding of the status of any potential competitors to Velac and any timing on that? What is in your internal plan for such a competitor?

---

**Greg Vontz** - *Connetics - COO, EVP*

Believe it or not, it's the first time we've gotten that question. I'm kidding. (laughter) We do get it all the time.

Well, as I alluded to in my comments, Deb, we know a lot about our product. And that's all we know anything about, frankly. And we're very confident in the dataset that we've got. We believe it's one of the strongest data sets for an acne products submitted to the FDA. And we're obviously very excited to launch it.

While we have no specifics on competitors, I think from a prudent standpoint, based upon what we've heard in the market, it's our assumption that there will be a potential competitor to Velac. And that's the way we've modeled our commercial activities and our sales forecast.

I have a lot of confidence in the strength of our data. I've got a lot of confidence in the strength of our sales force. And although we have anticipated in our A scenario, if you will, a competitor in the market, we continue to believe we'll be very successful with our products.

---

**Deb Nobleman** - *Piper Jaffrey - Analyst*

Okay, so your '05 guidance does include a competitor launching in 2005?

---

**Greg Vontz** - *Connetics - COO, EVP*

That is correct. That is our base case assumption.

---

**Operator**

Elliott Wilbur, CIBC World Markets.

---

**Elliott Wilbur** - *CIBC World Markets - Analyst*

Just a quick clarification question for John on the EPS guidance for '05 -- the 88 to 92 cents does include the $5 million payment to Yamanouchi. Is that correct?

---

**John Higgins** - *Connetics - CFO, EVP*

It does, but just a very, very small proportion. The 5 billion will be a cash payment we expect to go out the door, so to speak, in the third quarter. Originally, we had anticipated that, like our last milestone payments, this would be charged as a period expense, an in-process research and development payment, that would be charged to our operating expense. But given the fact that is a milestone based upon the approval, and therein the expected imminent launch of the product, it actually will be capitalized and be amortized as an expense over the life of the patent. The patent expires in the year 2014. So we'll just have a couple hundred thousand dollars that we'll actually hit our amortization line in the second half of 2005.

---

**Elliott Wilbur** - *CIBC World Markets - Analyst*

Okay. And then just taking a look at the total revenue guidance. You guys have brought up kind of the low end of the range, which you initially outlined at your analysts' meeting last year -- and just sort of going to those numbers and kind of comparing that to our own expectation and the expectations that seem to be out there on the street. I guess based on your product guidance, it looks like you're maybe a little bit -- quite a bit more bullish on the acne side of the business than seems to be reflected in the Street numbers.

And given that it's roughly a 10 percent pricing increase on Luxiq and OLUX late in the year, it seems like your guidance there is somewhat conservative. So I'm just trying to maybe get a little bit better color sort of on that observation?

---

**Greg Vontz** - *Connetics - COO, EVP*

Well, I'm not quite sure how to answer that, Elliott. I mean, we try to give the best clarity we can on our forecast. Yes, we brought up the bottom end of the range. Primarily at this

time, due to the trends we're seeing in the market, and the impact of our expanded sales force.

So as John said, although clearly, OLUX and Luxiq are maturing in their lifecycles, it continues to be our goal to increase volume growth across every product in our product line. It's going to vary, obviously, considerably among products. But even Luxiq and OLUX -- we are anticipating volume growth this year. But I guess specifically, it is a function more than anything else of the expanded sales force.

---

**Elliott Wilbur** - *CIBC World Markets - Analyst*

And then just one last question. Is there anything at this point that we can say further about U.S. Patent Number 275 licensed to Medasys (ph) that supposedly your Velac product may infringe upon -- just I guess there's not much to say at this point.

---

**Greg Vontz** - *Connetics - COO, EVP*

No, I don't think there is. I think our press release said it all. We were notified. We're confident of our patent position.

---

**Operator**

Michael Tong, Wachovia Securities.

---

**Michael Tong** - *Wachovia Securities - Analyst*

Just a couple quick ones. I noticed account receivables went up to 25 million versus 13 million in Q3. I was wondering, John, if you can give us some color on that.

And secondly, if I look at your EPS guidance during the analyst day, excluding the Velac payment, it was about 90 cents to $1. And now, we're seeing 88 to 92 cents. I was wondering between then and now, what has changed to cause that change in terms of your EPS guidance? And finally, was there a pipeline fill in Q4 for Evoclin that's not reflected in product sales?

---

**John Higgins** - *Connetics - CFO, EVP*

Okay, just to break it down, in terms of accounts receivable -- at year-end, they were a bit higher than obviously the prior quarter. I think the 2 principal factors there are 1, the launch of Evoclin. Again, the sales of that product principally did not hit until the second or third week of December, which is significant. And I think you'll see an A/R bump with the launch of any product within the quarter it is launched.

Secondly, we, as I indicated, entered a couple distribution service agreements. They were with 2 of our larger wholesalers. And it was about a 5- to 6-week process where, although it was a collaborative dialogue, in terms of looking at inventory levels and in making sales to those channels, several orders were placed in December.

Specific to our guidance, I think what we're very excited about, first in terms of revenue and earnings, is our outlook for 2005. It is we think consistent, if not better than what we were expecting 6 months ago.

As far as the earnings number that you cited, you're right. Initially, we did anticipate that Velac would hit -- it would be a 10- to 12-cent charge in '05. In fact, we are able to frankly reinvest that money in our business without having any impact on our earnings. That will now be spread over the 10-year life of the patent. We are able to invest not only more in our sales force but in our market activities.

And this is significant -- we are clearly managing some very significant dermatology products. We think Evoclin will be a big success, and are quite excited about the launch activities for Velac.

So we are redistributing our expenses -- although we have not given detail in the past, we have redistributed our expenses and are very pleased with the business we're funding as well as the profits this business will generate in 2005.

---

**Greg Vontz** - *Connetics - COO, EVP*

Michael, could you restate your question on the fourth-quarter Evoclin number?

---

**Michael Tong** - *Wachovia Securities - Analyst*

Yes; was there Evoclin shipment that weren't recognized in the 2.9 million and sales?

---

**Tom Wiggans** - *Connetics - President, CEO*

No. The commercial team had clearly -- having launched several products -- very sophisticated, in terms of our stocking analysis. We want to make sure there's an appropriate level of stocking at the retail pharmacy level -- did some careful calculations, and no, essentially, what we have booked is what was shipped.

---

**Greg Vontz** - *Connetics - COO, EVP*

Michael, let me just add one other comment there. We are already very encouraged, I think, by the number of reorders that are being placed already for Evoclin. So hopefully, this will soon become too small a base, and we will see a lot of growth to support demand in the channel.

---

**Operator**

David Buck, Buckingham Research Group.

---

**David Buck** - *Buckingham Research Group - Analyst*

A couple of questions for either Tom or Greg. First, on the signing of the inventory or distribution services agreements, which I guess is the PC term these days, can you give us a sense of where your trade inventories are going to be targeted going forward, and where they are versus that target? And I have got a couple of follow-ups.

---

**Tom Wiggans** - *Connetics - President, CEO*

Well, with regard to the inventories, I think other than as John explained, while we are negotiating these -- there were some orders that were held, and then were shipped after the agreements were placed. Our inventory levels during this transition period were not appreciably different. I think once we signed these, the good news is that we got probably better visibility than we have ever had on the inventory levels, and that is obviously very useful to us. But in the past, versus our historical inventory levels, they are fundamentally unchanged to these to wholesalers as a result of the DSAs.

---

**David Buck** - *Buckingham Research Group - Analyst*

And where would you be targeting -- is it 1 month, 0.5 months, 1.5 months --?

---

**Tom Wiggans** - *Connetics - President, CEO*

No, we target actually around 2 months -- in some cases, maybe a little bit more than that. I think if you look at the volume of our products and the distribution throughout the different distribution centers of the wholesalers, and into the retail level, we have concluded that we need a little higher inventory level to support the retail channel on these products that are -- this is not a Lipitor-velocity drug through the distribution channel.

Having said that, our inventory levels have stayed relatively constant over the last few quarters, if not year or so. And when we got the additional visibility on the channel, we were pretty pleased with what we saw.

---

**Greg Vontz** - *Connetics - COO, EVP*

Tom, let me just add a comment there for you. David, historically we work very hard, certainly in the era prior to having the DSAs in place, to make sure that the wholesalers did not speculate on us and did not get ahead of us on Rx's. The one thing we did see is when we were really pushing that down quite a bit, as our inventories got down to the 4-week mark, we began to see a pretty high frequency of stock-outs. As Tom said, there is now a pretty fair volume in the channel with our product, so we are pretty happy with where levels are at, in terms of making sure that we have products there when patients show up at the pharmacy.

---

**David Buck** - *Buckingham Research Group - Analyst*

Okay, and one for Greg -- as we look at 2005, any changes that you are seeing for the managed care side, in terms of copayment level, formula or acceptance, etc. And just a clarification and follow-up to one of Elliott Wilbur's question -- the price increases that you had in the fourth quarter -- was there anything else besides the 9 percent, I believe, for OLUX and Luxiq in October?

---

**Greg Vontz** - *Connetics - COO, EVP*

David, generally, we really don't comment on our price increases, but your assumptions are correct.

With regard to the managed care environment, I can speak to all of our products. If you have a specific product question, I can give you more detail there. Right now, I think the trends

in general, independent of products, are for managed care systems to increasingly move costs to their patients. So I think what you are going to see over time is more and more of the copay, especially at levels -- Tier 2 and Tier 3 -- seeing those increase. But for the time being, they don't seem to be moving too quickly. About two-thirds of our products are currently contracted at the second tier, and we would anticipate that to continue for the rest of our contracting activities. We have about 160 million lives under contract total right now, and will -- once at the conclusion of our activities at the end of Q1, we will probably have close to 200 million lives at that point, and we would estimate about two-thirds of that will be at the second tier.

---

**David Buck** - *Buckingham Research Group - Analyst*

Okay. And if I look at OLUX, Luxiq, and Evoclin, what is the average copayment for those?

---

**Greg Vontz** - *Connetics - COO, EVP*

Those are on Tier 2. So it depends upon each individual plan, but probably a range of anywhere from $10 to $30, depending on the plan.

---

**Operator**

Dave Windley, Jefferies & Company.

---

**Dave Windley** - *Jefferies & Company - Analyst*

Good afternoon, gentlemen. Is it possible to provide any additional color on where you stand in your discussions and negotiations on a replacement partner UCB?

---

**Tom Wiggans** - *Connetics - President, CEO*

It is a priority for us. As Greg alluded to, it is a corporate goal this year. We reviewed those at the J.P. Morgan conference, and specifically called it out. UCB will be our partner through March 31. So all I can say is stay tuned.

---

**Dave Windley** - *Jefferies & Company - Analyst*

Okay. Do your guidance numbers for 2005 assume a particular point in time at which you will have a partner in place?

---

**Tom Wiggans** - *Connetics - President, CEO*

Our guidance for 2005 right now is based upon our current information, and as we -- if and when we sign up a partner, we will give you an update on that.

---

**Dave Windley** - *Jefferies & Company - Analyst*

Okay. John, on the expense guidance, is D&A buried in one of the two expense lines that you are guiding?

---

**John Higgins** - *Connetics - CFO, EVP*

I'm sorry, can you repeat the question again?

---

**Dave Windley** - *Jefferies & Company - Analyst*

Is D&A lumped in with SG&A in your guidance?

---

**John Higgins** - *Connetics - CFO, EVP*

No, that is separate. And again, for the full year 2005, we are forecasting 16 to 16.5 million for depreciation and amortization. And just to come back, as well, to the revenue guidance question I believe you were asking of us -- as it relates to the copromotion partner, clearly, that is a corporate goal. Presuming we are successful there, we will announce the deal, the structure. The guidance that we have given does not assume revenue from a copromotion partner.

---

**Dave Windley** - *Jefferies & Company - Analyst*

So it would assume that you get some tailwind script volume from the activities through March, but that the royalty payments to a partner would cease at March?

---

**John Higgins** - *Connetics - CFO, EVP*

That's right. The UCB contract -- they are still actively promoting for us. We will have a promotion fee in the first quarter, payable to UCB, but their promotion activity will discontinue at the end of March.

---

**Dave Windley** - *Jefferies & Company - Analyst*

Okay, and last question, dovetailing a little bit on Mr. Tong's earlier question on AR -- generally speaking, is there anything on any movement that you would expect on the balance sheet that would skew cash flow results for 2005 above or below, say, what would be a normal level vis-a-vis net income?

---

**John Higgins** - *Connetics - CFO, EVP*

No, it is a clean and a fairly transparent business. We have identified the Velac milestone, which will be a cash payment we forecast in the third quarter. We have -- as we anticipate moving -- our lease expires in a couple of months. We will move. We have invested several million in a buildout, as well as had to pledge security deposits. But aside from that, no; it's a fairly low-capital business for us.

---

**Dave Windley** - *Jefferies & Company - Analyst*

Right, and so you would expect to exit 2005 at about the same DSO level as you exit 2004 --?

---

**John Higgins** - *Connetics - CFO, EVP*

That's correct. The last couple of quarters, the DSO levels, in fact, have been below average. As we have grown the business, we have got a very clean collection cycle. Historically, we have been in the 20- to 25-day range, but certainly, a very, very healthy DSO level.

---

**Operator**

Megan Murphy, Lazard Freres.

---

**Megan Murphy** - *Lazard Freres - Analyst*

A question -- maybe some color on the clinical trials that we'll be looking at for this year? Can we get a sense of what's an NDA program, what's a 505b2 program, and then maybe what kind of arms we're talking about in each of the trials -- specifically relative to placebo, noninferiority, etc.?

---

**Tom Wiggans** - *Connetics - President, CEO*

Yes, Megan, happy to respond to that. Just to give you some approximations in these trials, these are all 505b2's planned for the time being, certainly for OLUX and VersaFoam and Desilux. These are versus placebo in this instance, in these trials. Enrollment is targeted roughly in the 500 to 600-patient range for all of the Phase III trials this year.

---

**Operator**

Mike Hearle, Leerink Swann.

---

**Mike Hearle** - *Leerink Swann - Analyst*

It's really just to clarify -- I guess the clarifications on the '05 sales guidance and forecast. But could you break out contribution from launched products of the 190 to 200 million? So, meaning, of that number, what's made up of the combination of Velac, Rogaine, and Lamisil in that number? Just really trying to get some aggregate organic growth rate for the year.

---

**John Higgins** - *Connetics - CFO, EVP*

I'll comment on the royalty and contract line first. We forecast that being relatively flat over 2004. We do have 2 dynamite partnerships with Novartis and Pfizer, but we don't expect those royalty lines to materially grow until 2006.

So our guidance -- when we give total revenue guidance of 190 to 200 million, that is principally all product revenue. As I indicated, we are looking at our acne product comprising approximately 20 percent of that revenue guidance, split fairly equally between Evoclin for a full year and Velac for a partial year.

---

**Operator**

Donald Ellis, Thomas Weisel Partners.

---

**Donald Ellis** - *Thomas Weisel Partners - Analyst*

Most of my questions have been answered by this time -- just a couple left. Regarding OLUX and Luxiq, with roughly a 9 percent price increase in the fourth quarter of '04 and a 10 percent growth estimate for next year, is it correct if we assume that your assumptions are for 1 percent unit growth for '05?

---

**Tom Wiggans** - *Connetics - President, CEO*

Well, let me answer that -- maybe a little more than that, Don. Our price increases because of our managed care contracts. There's not a straight flow-through on that 9 percent. So our yield is a little bit less than that.

---

**Donald Ellis** - *Thomas Weisel Partners - Analyst*

Okay. And in regards to Soriatane -- I think you guys stated that your expectations for 20 percent growth '05 versus '04. Are we assuming that you're expecting your prescriptions to grow to make up most of that, or is that mostly going to be price?

---

**Tom Wiggans** - *Connetics - President, CEO*

Well, you know, as Greg said, we don't prospectively comment on price increases. All we will say is that -- as I said on our third-quarter call, our expectation is we should see volume growth in Soriatane. And we expect to see -- for those of our sales force that are listening (laughter), we expect to see some unit growth in Soriatane in 2005.

---

**Donald Ellis** - *Thomas Weisel Partners - Analyst*

Okay. Last question is about Soriatane. You guys made a comment on this call that you're not expecting generic competition for Soriatane in calendar '05. Can you let us know what gives you that level of confidence?

---

**Greg Vontz** - *Connetics - COO, EVP*

John, as we have talked before with a number of folks, we did an extensive amount of research in the diligence process for the acquisition of this product. And that process gave us a lot of clarity on where respective manufacturers stood with their abilities to not only produce, but to generate a bioequivalent form of the product.

One of the unique aspects of Soriatane is it goes through an intermediate processing step between the creation of the API and the capsule filling. And that is unique and very critical to the bioavailability of the product. So we are of the mindset that that bioavailability issue has not been cracked as of yet in a timeframe where an ANDA would impact us in '05.

---

**Tom Wiggans** - *Connetics - President, CEO*

Just to follow-on to that -- while we don't have perfect information, again, our planning scenario is through '05, we won't see any generics. And if that occurs, Soriatane will have been and will continue to be an excellent financial and strategic acquisition for us.

---

**Operator**

Elliott Wilbur, CIBC World Markets.

---

**Elliott Wilbur** - *CIBC World Markets - Analyst*

On calcipotriene, it just seems to me like maybe there was an acceleration in that program based on your comments from last conference call. And I want to make sure that if that is correct, that I did catch that -- and if so, why?

---

**Tom Wiggans** - *Connetics - President, CEO*

Elliott, it's a very, very exciting products. As you know, the Dovonex, the active ingredient is a vitamin D analogue. And the Dovonex product line right now had sales roughly in the $125 million range.

The other thing driving this is, frankly, the patent landscape. The pivotal patents will expire in late '07. So this is timed to coincide to introduce a product shortly thereafter.

---

**Elliott Wilbur** - *CIBC World Markets - Analyst*

Okay, so it is on track essentially with what you said last time --? (multiple speakers) That's fair.

Okay, and one just additional follow-up question for John with respect to the EPS guidance -- does that include any impact from SFAS 123? And if you could just -- you probably don't have a full-year number yet. But if you have it handy, just sort of year-to-date, what the impact was --?

---

**John Higgins** - *Connetics - CFO, EVP*

Elliott, you are referring to the requirement to expense stock options. No, it does not. As we indicated toward the end of our press release, the guidance does not reflect the impact of stock options expensing. We expect we will begin to expense options as required in the third quarter, and later on

in the year, we will give more details how that impact -- or how that will impact our Company.

---

**Operator**

David Buck, Buckingham Research Group.

---

**David Buck** - *Buckingham Research Group - Analyst*

Yes; just a couple of follow-ups. First, to follow-up on the stock option question -- in your current options scheme and playbook (ph), can you just review, John, what the number would be in terms of EPS on a full-year basis? And obviously, it's just a half-year. But just remind us of that. (multiple speakers) And also, if you have the cash from operations number and free cash flow for the fourth quarter, that would be terrific.

---

**John Higgins** - *Connetics - CFO, EVP*

Yes. The 9-month number, which is from our 10-Q, is just below $5 million total for 2004. When we file our 10-K, of course, we will have the full-year number. But that is the 9-month -- value of our options for the first 9 months of this year.

Your second question -- I'm sorry; it related to --

---

**David Buck** - *Buckingham Research Group - Analyst*

Just if you have the data, the free cash flow -- or cash flow from operations numbers for the fourth quarter and year?

---

**John Higgins** - *Connetics - CFO, EVP*

David, I will follow up with you. I don't have that (multiple speakers) handy with me right now.

---

**Operator**

Ladies and gentlemen, we have reached the end of the allotted time for questions and answers.

---

**Tom Wiggans** - *Connetics - President, CEO*

Thank you all very much.

---

**Operator**

This concludes today's fourth-quarter financial results. You may now disconnect.

---